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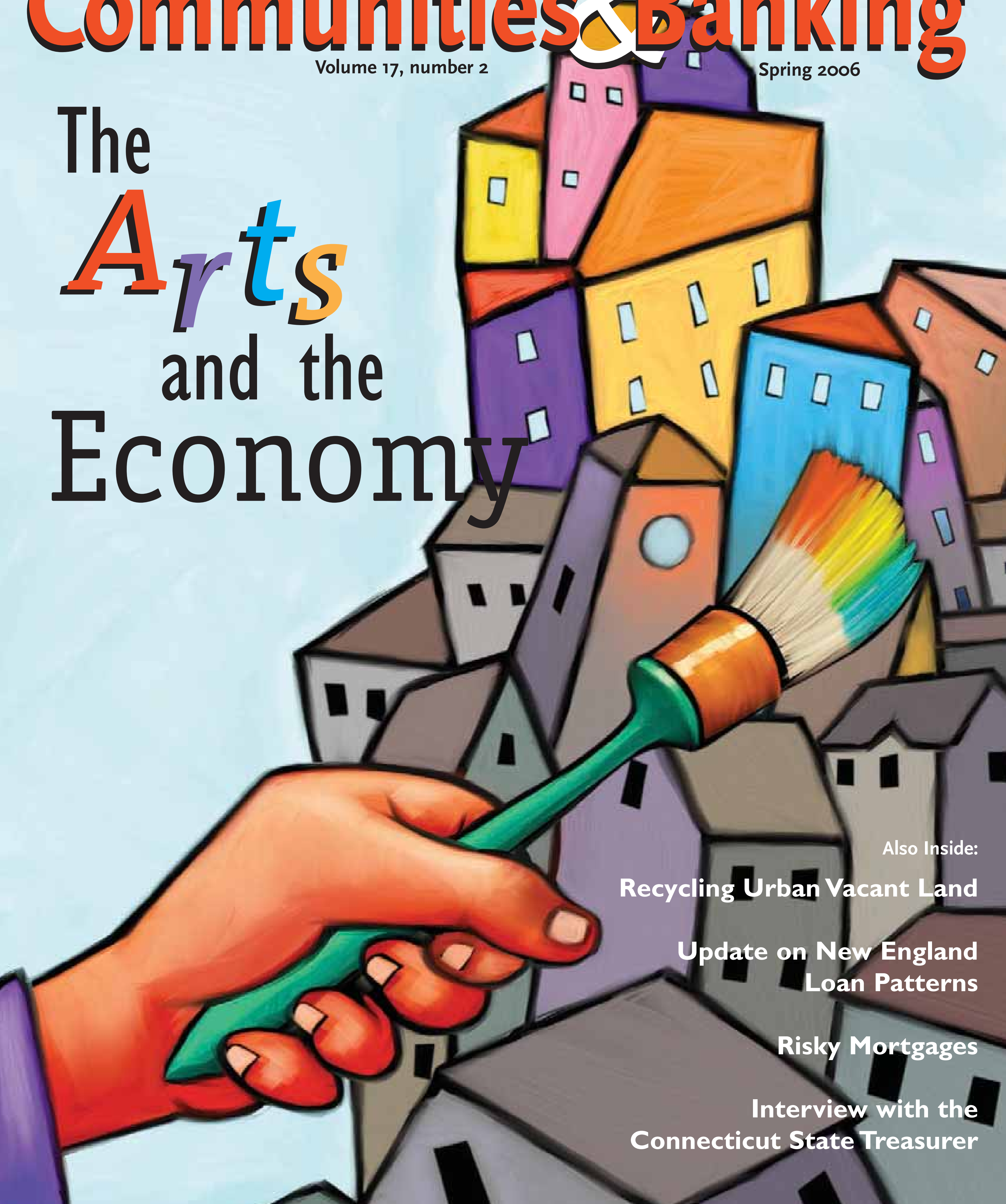
The Arts and the Economy



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Communities & Banking seeks to offer insightful articles on topics in community development and fair access to credit, with a focus on innovative research and effective programs and partnerships in New England.

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Caroline Ellis
Editor, *Communities & Banking*
Federal Reserve Bank of Boston
600 Atlantic Avenue
Boston, MA 02210
(617) 973-3187
caroline.ellis@bos.frb.org

For free subscriptions, contact:
Public and Community Affairs
Federal Reserve Bank of Boston
600 Atlantic Avenue
Boston, MA 02210
(800) 409-1333
bostonfed.publications@bos.frb.org

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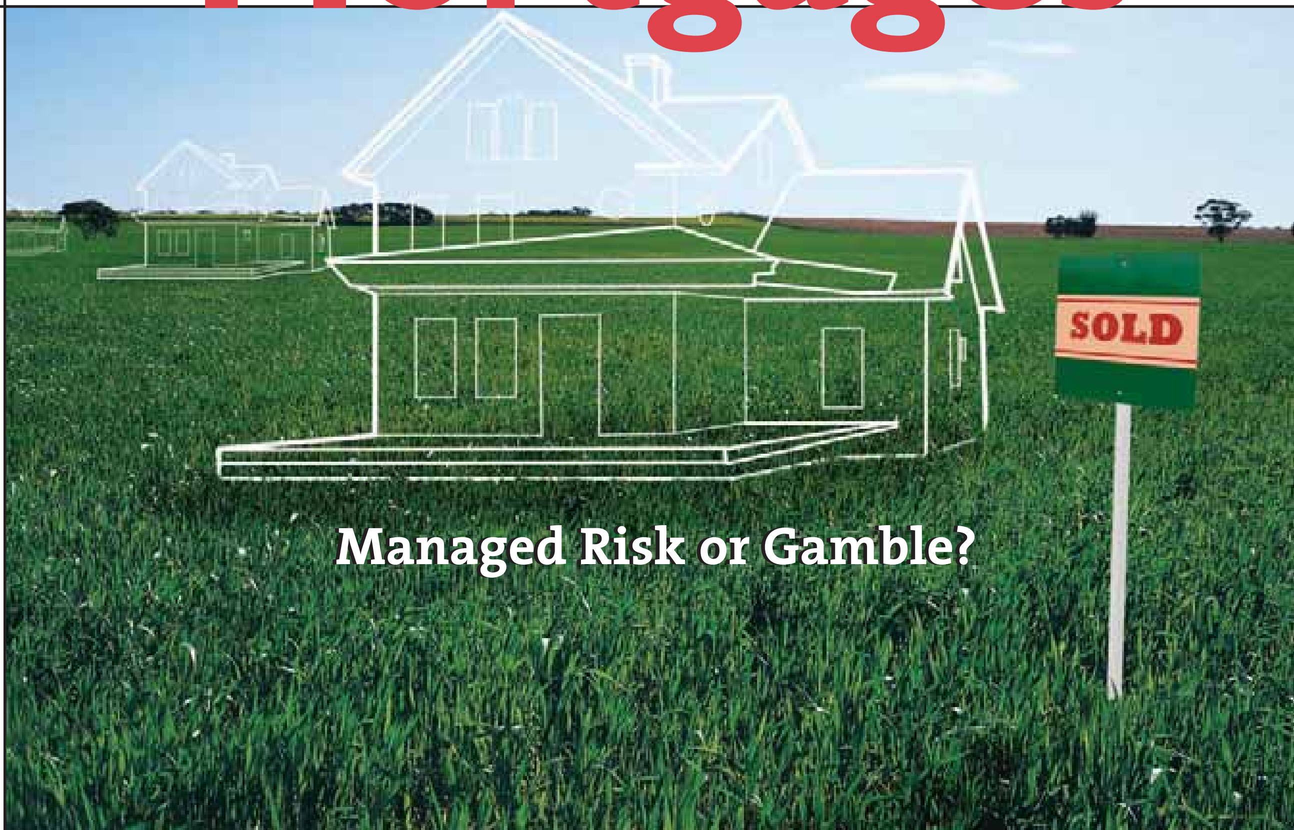


Managed Risk or Gamble?

by Andrew Olszowy • Federal Reserve Bank of Boston

Recent years have seen an explosion in alternative mortgage products. Although instruments such as *interest-only* loans, *payment-option* adjustable-rate mortgages (ARMs), and *reduced-documentation* ("low doc" or "no doc") mortgages have existed in various forms for a long time, their widespread use is new. According to the Mortgage Bankers Association, interest-only loans, for example, comprised 23 percent of all U.S. mortgages for the first six months of 2005—up from 17 percent in the prior six months.[1]

Consumer Risks

Although there are numerous issues to consider, probably the most significant risks to borrowers with regard to alternative mortgages are the following:

Payment Shock — This occurs primarily in interest-only and option adjustable-rate mortgages (option-ARMs). In an *interest-only* loan, the borrower is required to pay only the interest for a specific period of time (typically three to five years). The rate may fluctuate or may be fixed. After the interest-only period, payments start to include interest *and* principal. In a *payment option-ARM*, the borrower typically can choose from four payment options. These can be a minimum payment based on a "teaser," or low introductory rate; an interest-only payment based on the fully indexed rate; or a fully amortizing principal and interest rate based on a 15-year or 30-year term. In both loans, after the initial period is completed, the loan is "recast" (requires payments that will begin to amortize or pay down the principal), and the borrower must begin making payments to pay off the loan. That is when payment shock hits. If the borrower had been making only the minimum payment, the fully indexed, fully amortizing payment might be 50 percent higher or even double what the original payment was. If the borrower could afford only the minimum payment in the first place, the financial hit could be disastrous.

Negative Amortization — In option-ARMs and other alternative mortgages, loans can experience *negative amortization*. When the borrower opts to take the very low teaser payment options offered on such loans, the amount is typically not only insufficient to reduce principal but also insufficient to cover the interest portion of the monthly payment. In layman's terms, the monthly payment is so small that the borrower is actually increasing the amount borrowed every month, because the amount of unpaid interest is added to the principal each month. After the initial period is completed or once the principal hits a trigger amount, the loan recasts. At this point, if the borrower has made only the minimum payments, the loan amount outstanding is often more than the original amount borrowed.

In addition to the risk to consumers, there are risks to lenders, and the rapid growth of alternative products have caught the attention of federal regulators. In late December 2005, regulators released proposed joint guidance to financial institutions on how to manage the risks presented by nontraditional mortgage products.[2] Are their concerns warranted? When does taking a reasonable risk cross over into gambling?

How Alternative Mortgages Work

People like the flexibility of alternative mortgages, and if borrowers are aware of inherent risks, there are situations in which a nontraditional mortgage makes sense. For example, an interest-only or option-adjustable-rate mortgage might be a reasonable choice for a couple if one spouse is employed and the other has a firm opportunity to go to work in the near term. The initial period of low monthly payments would allow them to support the mortgage on one income until the other spouse's income can contribute to the larger monthly payment. However, in too many cases, the benefits of alternative mortgages come at a price.

A typical 30-year fixed mortgage is like a two-wheel bicycle—fairly basic transportation. The rider needs to learn how to balance and must be careful not run into anything. Even if riders run into something, they usually walk away with just a few bruises. An alternative mortgage is more like a sports car. The sports car accomplishes the same objective as a bicycle—transportation—but it is a much more complex device, requiring specific knowledge and the ability to manage multiple tasks simultaneously. If something goes wrong, the stakes are higher.

Similarly, alternative mortgages are fairly sophisticated. The borrower must weigh multiple considerations. What is my current income? Will I have at least this much income as long as I have mortgage payments? Will interest rates go up or down? Can I be certain that housing prices will appreciate? Many borrowers cannot answer such questions beyond the near future.

The Popularity Puzzle

So given their complexity and long-term uncertainty, why have these products become so widespread? Probably the most significant factor has been the state of the housing market. With homes in certain markets appreciating more than 100 percent over the past five years alone, affording a home has become increasingly difficult.

In such steeply appreciating markets, alternative mortgages and low initial payments have been attractive to buyers. In fact, some financial institutions have been promoting alternative mortgages as "affordability" products, potentially misleading consumers about the products' potential costs and raising the concern of regulators.

Some borrowers do count on their income to increase as payments increase, but regulators worry that many other borrowers have no exit strategy and are essentially gambling on housing prices continuing to appreciate. They may expect to cash in on the home's equity and quickly refinance with another interest-only loan or option-ARM.

However, if the real estate market slows or takes a significant downturn, refinancing may not be possible. Even worse, if the loan had been experiencing negative amortization, an increased loan amount coupled with a softening real estate market could mean the borrower owes more on the house than it is worth—a scenario that is making regulators anxious. (See the exhibit "Consumer Risks.")

What Lies Ahead?

The quickly appreciating real estate market has created an unprecedented boom in alternative mortgages. However, no one can anticipate the effect of a significant downturn, as such a volume of these products has never been stress-tested in the marketplace. A downturn could hurt both consumers and financial institutions holding a sizable portfolio of such loans.

Comments in late 2005 from the Comptroller of the Currency John Dugan and then-Federal Reserve Chairman Alan Greenspan highlighted regulators' increasing concern. Dugan stated that option-ARMs are increasingly becoming "the primary way to afford the large mortgages necessary to buy homes in many housing markets." He also expressed concern that the use of alternative mortgages to "penetrate the subprime market cannot be far behind."

Greenspan hinted that the proliferation of alternative mortgages may be creating a Catch-22 situation in housing markets by "adding to the pressures in the marketplace." As he explained, "Some households may be employing these instruments to purchase a home that would otherwise be unaffordable." Rather than choose a more affordable home or wait for the market to cool, some borrowers do appear to be using alternative mortgages to purchase homes they cannot afford. That may be contributing to what Greenspan called "froth" in the housing market by artificially maintaining inflated prices.

Adding to regulators' apprehensions is a practice called *layering*. Layering occurs when a financial institution combines several alternative or exotic features in one loan product. For instance, an option-ARM may also have a low-doc feature: The lender doesn't demand the usual documentation and, instead of verifying applicants' income, accepts what applicants "state" is their income.

Layering obviously results in increased risk to both parties. The typical lender compensates by raising the loan's interest rate. But if the consumer has an interest-only loan or option-ARM, that can actually lead to worse payment shock down the road—and an increased likelihood of default.

Be Cautious

So what do regulators suggest? Basically, proceed with caution. In December 2005 federal regulators released proposed guidance suggesting that financial institutions should follow prudent lending practices with alternative mortgage products. Regulators said that lenders should consider the borrower's ability to repay the debt, should not rely on credit scores as substitutes for verifying applicants' income, and should emphasize the borrower's ability to repay the debt more than they emphasize the value of the collateral. Also, if lenders intend to layer the risks rather than simply increase the interest rate, they should look for higher credit scores, lower loan-to-value and debt-to-income, and other mitigating factors. That may appear to be simply sound loan underwriting. But regulators recognize that the competition in alternative products may be putting new pressure on lenders.

Regulators also strongly encourage lenders to educate consumers with easy-to-understand product information, promotional material, and discussions. They need to address the pros and cons so that consumers can see if an alternative mortgage is the correct fit.

And what should consumers be doing? If the lender is not providing easy-to-understand product information, they should be asking questions:

- **Payment Shock** — When does the introductory rate expire? When do payments begin to pay down the loan? How are payments calculated? Can the lender give a maximum hypothetical example of what the payment might be?

- **Negative Amortization** — Can negative amortization occur? When is it possible under the terms of the loan? Can the lender provide a sample payment schedule to show the effect of negative amortization?

- **Prepayment Penalties** — Is there a prepayment penalty on the mortgage? How much is it in plain terms, and how is it incurred?

- **Reduced Documentation** — Is there a price difference between a low-doc loan and a standard loan? What is it?

Alternative mortgages are subject to consumer protection laws and regulations. Most notably, the Truth in Lending Act implemented through Regulation Z requires that certain disclosures be provided for an advertisement, for an application, and for changes in interest rates. Section 5 of the Federal Trade Commission Act makes it illegal for lending institutions to employ any unfair or deceptive acts or practices. Thus lending institutions should review their procedures with regard to alternative mortgages to ensure they are following regulations.

Similarly, consumers should ask questions to be sure they understand all the finer points and potential consequences of alternative mortgages. And because the disclosures under Regulation Z are triggered only at application, both the consumer and the lender should make a point of having an informative dialogue before then.

Although alternative mortgages can be a useful tool allowing flexibility to both the consumer and the lender, the increased risk does require that both parties proceed prudently. Neither consumers nor lenders should gamble that housing markets will continue to appreciate rapidly. If all involved parties proceed carefully and cautiously, potential problems can be avoided.

Andrew Olszowy *is Managing Examiner of the Consumer Affairs Supervision and Regulation unit at the Federal Reserve Bank of Boston.*

Endnotes

1 See http://www.mortgagebankers.org/news/2005/pr1025d.html.

2 For the Federal Financial Institutions Examination Council's proposed guidance on alternative mortgage products, see http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20051220/default.htm.

Illustrations by Kirk Lyttle

by Beate Becker

The Creative Economy

A new idea is sweeping the region—the *creative economy*. At its core is a growing recognition that culture can not only enhance life and revitalize communities, but also foster new industries and employment.

In Portland, Maine, for example, Grammy Award-winning musicians may be seen arriving to work on CDs at Gateway Mastering & DVD. Bob Ludwig moved the company there from New York City in 1993, generating local jobs and helping to strengthen the city. Ludwig chose Portland for its beauty, accessibility, and quality of life, which is reflected in its fine restaurants and arts district, and in institutions such as the Portland Museum of Art and the Maine College of Art.

Portland has capitalized on such attractions with a purposefulness now seen throughout New England. Bangor in Maine, Pawtucket in Rhode Island, New Bedford in Massachusetts, and North Bennington in Vermont are among the towns establishing arts districts and converting empty factory buildings to artist lofts and cultural facilities. Lowell, Massachusetts, for example, found that even after considerable infrastructure investment, a deliberate outreach to artists—with favorable zoning, affordable live-work space, and targeted financing programs—was the best way to breathe life into its deserted downtown.

Studying the Opportunities

The New England Foundation for the Arts and the state arts agencies have long measured the economic impact of nonprofit cultural organizations. Additionally, the Massachusetts Cultural Council has since 1997 supported economic-development projects led by cultural organizations. But in 2000 the New England Council and a regional coalition of businesses, state arts agencies, and cultural leaders introduced a new approach. They described it in a report called *The Creative Economy Initiative: The Role of Arts & Culture in New England's Economic Competitiveness.*[1]

Maine's efforts go beyond community revitalization and cultural tourism to include efforts to develop local creative industries.

In defining the creative economy, the Creative Economy Initiative (CEI) went beyond the nonprofit cultural sector and took into account the economic impact of private commercial enterprises and self-employed creative people. It also looked at cultural activities embedded in noncultural organizations and the value that creative skills add to industries such as tourism, manufacturing, and technology.

The CEI report found that New England's creative economy, thus defined, employed nearly a quarter of a million residents (3.5 percent of the region's workforce) and supported an annual payroll of $4.3 billion. At the time of the study, jobs within the sector were growing faster than in the New England economy as a whole, and cultural-tourism dollars amounted to an estimated $6.6 billion. Today a New England Cultural Database lists more than 19,000 entities in the region's creative economy.[2]

In 2001, the Creative Economy Initiative produced another document, *A Blueprint for Investment in New England's Creative Economy*, which mapped a strategic action plan for developing what it called *creative clusters*, *creative workforce*, and *creative communities* in New England.[3] Many of the proposed initiatives have been carried out on state and local levels. The Vermont Council on Rural Development, for example, conducted statewide forums on culture and innovation that, among other things, led to the recent launch of the Creative Community Program.[4]

The most comprehensive effort, however, is taking place in Maine, where Governor John Baldacci has made the creative economy a central part of his economic-development program. Following a statewide conference in May 2004, Baldacci appointed a Creative Economy Council comprising business, financial, cultural, and civic leaders.[5] In addition, there is a Creative Economy Steering Committee charged with addressing multiagency challenges such as getting alignment among housing, lending, and cultural interests in town centers.

Maine's efforts go beyond community revitalization and cultural tourism to include efforts to develop local creative industries. The state is following a path taken in Europe, the United Kingdom, Canada, and parts of Asia, where public policy supports the growth of industries such as advertising, architecture, crafts, design, fashion, gaming, media, music, the performing arts, publishing, software, computer games, television, and radio.

Types of Creative Industry

Maine is fostering creative clusters such as fiber arts and fabric architecture, literature and humanities, boatbuilding, and wood products. Last fall the governor led a trade mission to France with representatives from the boatbuilding, wood products, culinary, and tourism industries. Meanwhile, researchers at the Margaret Chase Smith Policy Center at the University of Maine in Orono are studying emerging creative clusters and assessing what policies and resources are best at fueling growth in the creative economy.

Crafts

Future creative production capacity is often rooted in an area's economic and cultural heritage. Traditional occupations and know-how, along with new technologies and an understanding of contemporary markets led, for example, to the formation last year of Maine Built Boats, an industry association serving the 450 companies and 5,000 workers tied to boatbuilding.

MBB is stressing Maine's quality craftsmanship, maritime heritage, and cutting-edge technology to establish a global presence as it leverages group marketing power to compete with New Zealand in the luxury yacht market. The state is planning apprentice programs to develop boatbuilding skills, and it hopes that the craft will create a ripple effect in sail making and furniture.

Similar economic potential exists in the emerging textile and fabric-architecture cluster, which includes companies such as Angela Adams, Moss, Transformit, and Collabric. Many of the companies' women stitchers learned from their mothers and grandmothers and were formerly employed in the shoe, textile, and sail-making industries.

Technology

But the creative economy is not limited to traditional crafts. New England's technological prowess provides ample opportunities for creative endeavors that involve digital animation, gaming, and sound engineering.

One pillar of the creative economy, WGBH in Boston, can lay claim not only to being the largest single producer of prime-time PBS programming, but also to fostering a community of independent filmmakers and producers whose work establishes New England as a leader in documentary and educational media production. The Massachusetts legislature, having recognized the value of those sectors, enacted a law in late 2005 to provide payroll, production, and sales-tax credits to film producers shooting in Massachusetts.

The Role of Educational Institutions

Local creative industries also owe much to the region's strength in education. Most of New England's nearly 270 colleges and universities offer some type of training in the literary, visual, performing, and applied arts. Specialized schools such as Rhode Island School of Design, Massachusetts College of Art, Berklee College of Music, and Yale School of Drama draw students from around the world and train a creative workforce that applies its skills to a broad range of industries.

Incubating

Additionally, educational institutions are often the prime movers and anchor tenants in downtown revitalization efforts. They may provide studios, incubator space, and business training for creative entrepreneurs. In Rhode Island, RISD and Bryant College jointly support the Center for Design and Business. Massachusetts has Salem State College's Enterprise Center, and Rockport, Maine, boasts the Studio Center for Furniture Craftsmanship.

Maine also has identified as vital components of its creative economy dozens of non-degree-granting arts and crafts programs, such as Haystack Mountain School of Crafts and the Skowhegan School of Painting and Sculpture.

Reaching out to Youth

Governor Baldacci says he is committed to the creative economy in part because it captures the attention of Maine's youth. He believes that the future depends on retaining young people and providing them with employment opportunities that are both personally satisfying and remunerative.

One exemplary model of a New England career-exposure and training program is Youth Design Boston, a partnership initiated by the Boston chapter of the American Institute of Graphic Arts in collaboration with the City of Boston and the Private Industry Council. Through the program, Boston public high school students are recruited for intensive summer internships with local design firms. The internships give young people demanding work experience in the creative economy while serving employers' needs.

Much has been accomplished since the concept of the creative economy was first introduced in New England. But the economic potential of these efforts will be realized only when the creative economy is fully integrated into state and local economic-development agendas. Maine's comprehensive efforts in this area are setting an example for the entire region.

Beate Becker *is the former director of the New England Creative Economy Initiative. She was co-author with Mt. Auburn Associates, Somerville, Massachusetts, of* The Creative Economy Initiative: A Blueprint for Investment in New England Creative Economy *and* Louisiana: Where Culture Means Business.

Endnotes

1 The *Creative Economy Initiative: The Role of the Arts and Culture in New England's Economic Competitiveness* (The New England Council: June 2000), http://www.creativeeconomy.org.

2 The database is sponsored by the New England Foundation for the Arts and the six New England state arts agencies. See http://www.newenglandarts.org/db.

3 The Creative Economy Council: A Blueprint for Investment in New England's Creative Economy. The New England Council. June 2001. See http://www.creativeeconomy.org.

4 "Advancing Vermont's Creative Economy: Final Report and Recommendations from the Vermont Council on Culture and Innovation," Vermont Council on Rural Development, September 2004, www.sover.net/~vcrd.

5 See http://www.mainearts.com/mainescreativeeconomy/conference/index.html.

Starting a

by Peggy Delinois Hamilton • Yale Law School

Community Development Bank

A New Haven Story

In starting a community development bank to meet the needs of low- and moderate-income residents, First City Fund Corporation is charting new territory in New Haven. The corporation is one of a select few nationwide showing that it is possible for nonprofits to establish strong banks.

Banking on Communities

Since the 1994 Riegle Community Development and Regulatory Improvement Act (commonly called the Community Development Banking Act), community development banking has become a cottage industry.[1] State or federally chartered and insured by the Federal Deposit Insurance Corporation, the banks have a primary mission of community development—typically, activities benefiting low- and moderate-income individuals or geographic areas.[2] Before 1994, there were two self-proclaimed community development banks: ShoreBank in Chicago and Elk Horn Bank & Trust in Arkadelphia, Arkansas. The law established the Community Development Financial Institutions Fund, which led to today's 750-plus community development financial institutions (CDFIs), 50 of them banks and thrifts.[3]

Communities start community development banks hoping to address local needs for capital, credit, savings, investment, and transaction services. The banks are an attractive alternative to check cashers in low- and moderate-income communities (who may deduct 2 percent) and payday lenders (who may charge as much as 400 percent).[4] To the extent that they provide for savings and investment, the new banks help create wealth and alleviate poverty.

It is possible for nonprofits to establish strong banks.

Starting a bank, however, is no easy task. Like any business, banks must have sound management, feasible business plans, and sufficient capital to sustain and grow the business. In addition, every bank must meet the safety and soundness requirements of one to four regulatory authorities before they open. The rules regulate not only the nature of the business and the qualifications for managers, but also how much capital must be raised and maintained.

First Things First

From my experience, raising the capital to establish a *de novo* community development bank is the most difficult step. In 1993, I was retained to help start City First Bank of D.C., a bank designed to serve low- and moderate-income neighborhoods in the District of Columbia.

From that odyssey, I learned that starting a community development bank has at least 10 discreet steps: (1) identifying the market need; (2) determining the type of financial institution that will best meet that need; (3) writing the business plan and submitting the charter application; (4) determining the need for other regulatory memberships (such as the Federal Deposit Insurance Corporation, Federal Reserve Board, or the Federal

Home Loan Bank); (5) determining the need for affiliates (such as a bank holding company, a financial holding company, or an operating subsidiary); (6) raising capital (at least $2 million net of preopening expenses); (7) securing the location; (8) hiring management; (9) providing a service and assessing impact; and (10) attaining and sustaining profitability. Of the five years it took to open that bank, raising the initial $9 million capital took nearly three.[5]

De novo community development banks often raise capital under Regulation D of the Securities Act of 1933. Regulation D permits the sale of securities without Securities and Exchange Commission registration—so long as the offer is not made to the public and does not involve a general solicitation. Such private offerings are made primarily to accredited investors, usually institutional investors or high-net-worth individuals.

Raising the minimum capital necessary to meet the bank's business needs and the regulatory requirements is difficult given the investment's illiquidity, the lack of operating history, the high operating losses expected initially, the focus on lower-income populations, and the competition from both unregulated lenders and traditional banks.

Motivating Socially Responsible Investors

Community development banks seek innovative ways to motivate potential investors. For example, they may participate in the New Market Tax Credit program, the Bank Enterprise Award program, and the CDFI Fund Financial Assistance Award program (all administered by the CDFI Fund) to obtain sources of capital.[6] Such programs often reassure private sectors and can help generate stronger financial returns. Community development banks also promote their "double bottom line." Because financial returns may be lower than for their peers, the banks reach out to investors motivated to help build affordable homes, create jobs, or launch small businesses.

Nonprofit organizations also are helpful in attracting capital to community development banks. The Internal Revenue Service recognizes nonprofits as federally tax-exempt because their purposes are charitable or promote social welfare. It also recognizes that sometimes those purposes intersect with community banking.

Supporting Social Welfare

Consider the nonprofit City First Enterprises, Inc., the bank-holding company of City First Bank of D.C. City First Enterprises is tax exempt under section 501(c)(4) of the Internal Revenue Code, which gives exemption to organizations that exclusively promote social welfare. The IRS saw the group's support for a community bank as part of its mission. With a successful application to the U.S. Department of Housing and Urban and Development and the Department of Housing and Community Development, City First Enterprises was able to contribute $4.5 million in initial capital to City First Bank. Having provided nearly half of the start-up money, City First Enterprises became the bank's controlling owner.

Working with Government

In New Haven, First City Fund Corporation—like City First Enterprises in Washington—is establishing and becoming controlling owner of a community development bank. However, First City Fund's tax exemption is under section 501(c)(3), so it can fulfill its charitable purpose by promoting community and economic development in New Haven and adjoining towns, where it can help with capital, credit, savings, investment, and transaction services to organizations and individuals in lower-income neighborhoods. It will work with city government in (1) spurring affordable housing and small business growth, (2) providing relief to the poor and underprivileged, (3) combating community deterioration, and (4) lessening government burdens. First City Fund Corporation plans to raise $25 million to help create the bank.

Raising the capital to establish a *de novo* community development bank is the most difficult step.

It is not new for nonprofit organizations formed "to relieve poverty, eliminate prejudice, reduce neighborhood tensions and combat community deterioration" to support loans and business enterprises in economically depressed areas. What *is* a new development is nonprofits taking a leadership role in providing financial services.

First City Fund Corporation in New Haven and City First Enterprises in Washington demonstrate that nonprofits can actually *start* a bank. Given their ability to attract socially conscious investors and provide a tax deduction for donations, nonprofits could be increasingly important in community development banking. Neighborhood groups and existing foundations would do well to consider this new way of making more financial services available to low- and moderate-income communities.

Peggy Delinois Hamilton *is the Selma Levine Lecturer in Clinical Law at the Yale Law School in New Haven.*

Endnotes

[1] Community Development Banking Act, P.L. No. 103-324,108 Stat. 2160 (Sept.23, 1994).

[2] See 12 CFR 25.12(g).

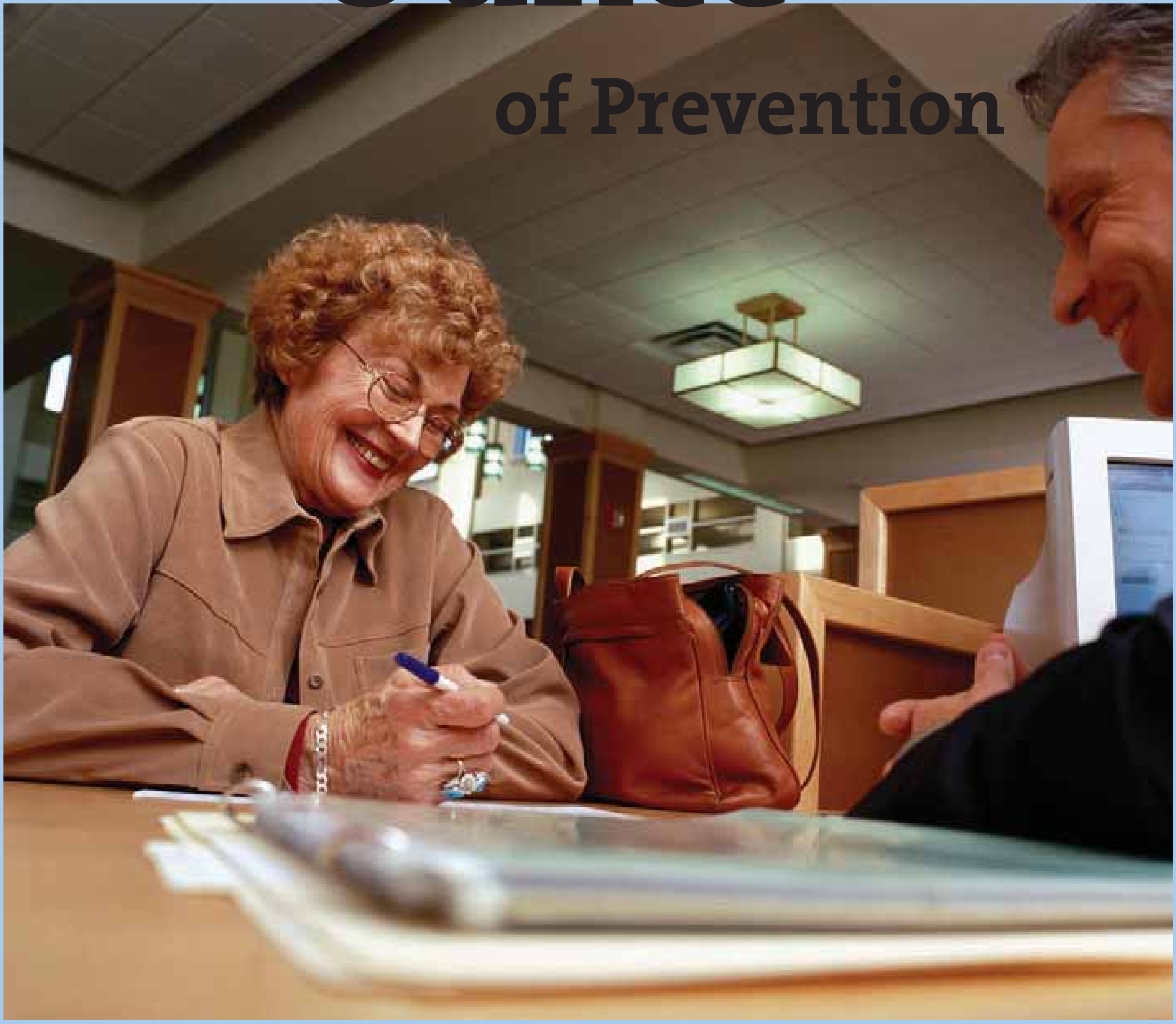
iii Certified CDFIs as of January 1, 2006, may be found at www.cdfifund.gov.

[4] Michael S. Barr, "Banking the Poor," *Yale Journal on Regulation* 21, no. 1 (winter 2004): 121-237.

[5] FDIC Statement of Policy on Applications for Deposit Insurance, February 28, 2003, at p. 5349 (available at http://www.fdic.gov/regulations/laws /rules/5000-3000.html). Normally, the initial capital of a proposed depository institution should be sufficient to provide a Tier 1 capital-to-assets leverage ratio (as defined in the appropriate capital regulation of the institution's primary federal regulator) of not less than 8.0 percent throughout the first three years of operation. In addition, the depository institution must maintain an adequate allowance for loan and lease losses.

[6] The New Markets Tax Credit Program permits taxpayers to receive a credit against federal income taxes for making qualified equity investments in designated community development entities. Substantially all of the qualified equity investment must in turn be used to provide investments in low-income communities. The credit provided to the investor totals 39 percent of the cost of the investment and is claimed over a seven-year credit-allowance period. Investors may not redeem their investments prior to the conclusion of the seven-year period. For the CDFI Fund New Markets Tax Credit Program see http://www.cdfifund.gov/programs/programs.asp ?programID=5. Through the Bank Enterprise Award Program, the CDFI Fund backs financial institutions dedicated to supporting community and economic development. The program complements the community development activities of FDIC-insured depository institutions by providing financial incentives to expand investments in CDFIs and to increase lending, investment, and service activities within economically distressed communities. For the CDFI Fund Bank Enterprise Award Program, see http://www.cdfifund.gov/programs/programs.asp?programID=1. Through the Financial Assistance awards, the CDFI Fund invests in CDFIs that demonstrate the following: they have the financial and managerial capacity to provide affordable and appropriate financial products and services that positively impact their communities; they are viable financial institutions; and they use and leverage CDFI Fund dollars effectively. Such awards are made in the form of equity investments, loans, deposits, or grants and must be matched by the applicant with funds of the same type from nonfederal sources. For CDFI Fund Financial Assistance Program, see http://www.cdfifund.gov/programs/programs.asp ?programID=7.

An Ounce of Prevention



by Richard A. Hylan • Massachusetts Money Management Program

Helping the Elderly with Daily Money Management

According to AARP, as many as 7 percent of adults receiving Social Security benefits have difficulty managing their household finances. For some, this amounts to no more than an occasional bounced check. But for others, the inability to keep track of their household finances may lead to unpaid bills, undeposited checks, cut-off utilities, bank foreclosure, or eviction.

If nothing is done about the problem, then guardianship or institutionalization may follow. Simple money-management issues can snowball and can result in the loss of elders' right to make decisions about where they live, what happens to their property, and how their money is spent. Although older people turn to social services for assistance with this and other issues, social-service agencies have not routinely provided help with money management.

Everett Donaldson gets assistance with money management from volunteer Julia Chapman in West Springfield, Massachusetts.

Recognizing that service gap, AARP developed a program in 1981 to deliver free money-management help directly to seniors in their homes. A system of safeguards, including detailed monthly reporting and third-party oversight, was created to protect both the elder clients and the money-management volunteers.

In 1991, Mass Home Care, a nonprofit network of 30 elder-service agencies, approached AARP and the Massachusetts Executive Office of Elder Affairs about starting a money-management program in the state. The program was launched with a grant from the settlement of a fraud case perpetrated on a senior and prosecuted by the Massachusetts Secretary of State. The grant provided start-up money for programs at six Mass Home Care "Aging Services Access Points" in the Boston area.

By 1999, 25 agencies had agreed to sponsor local money-management programs, making the service available to seniors in all 351 Massachusetts cities and towns. Shortly thereafter, Mass Home Care approached the state legislature for funding, and today, in an acknowledgment of the rapidly growing incidence of financial exploitation of elders, the effort receives nearly $900,000 annually in state operating funds as part of the Massachusetts Protective Services Program.

Recognizing that service gap, AARP developed a program in 1981 to deliver free money-management help directly to seniors in their homes.

The money-management program has an active caseload of roughly 1,200 clients per month and has helped more than 6,000 elders. It is now the largest program of its kind in the country, thanks to the spirit of cooperation among the program's three sponsors: Mass Home Care, AARP, and the state's Executive Office of Elder Affairs.

Two Ways to Help Seniors

Recognizing that different people have different financial needs, the Money Management Program offers two levels of service: *bill-payer service* and *representative payees*. With both services, trained, supervised volunteers are matched carefully with clients, taking both the volunteer's and the client's preferences into consideration. For example, volunteers can choose the places they are willing to travel to and whether to work in the homes of smokers or pet owners. Clients can state a preference for male or female volunteers and can ask for a different volunteer if the "chemistry" is not right. The volunteers, many of whom are AARP members, are required to maintain detailed monthly records using an AARP reporting system.

For most seniors, the bill-payer program is the most appropriate service. It provides assistance to low-income elders who are still able to make responsible decisions about their financial affairs but are unfamiliar with the bill-paying process and need guidance. The bill payer helps the client establish a budget, organize and send out mail, sign his or her own checks, and balance a checkbook.

Representative payees bear a higher responsibility for allocation of the client's funds than bill payers. Appointed by a government agency, usually the Social Security Administration, the representative payee administers the benefits of those who are not capable of making decisions about their financial affairs. (See the exhibit "One Senior's Story.") They open up a checking account in the client's name to pay the client's bills. Even though the account belongs to the client, the volunteer is the only person allowed to sign checks.

Each month, program monitors provide third-party oversight and sys-

One Senior's Story

Larry is 65 and lives in senior housing in Boston. His health is reasonably good, but his memory has begun to fail. In December 2003 he was facing eviction because the housing authority suspected that his daughter was living with him in violation of affordable-housing policy. His phone bill showed more than $1,000 in calls to places he had no reason to call, and when he failed to pay, he lost his phone service. His other expenses were also in arrears, his debts were mounting, and his monthly income disappeared at the beginning of each month because of large withdrawals he did not recall making. His daughter said she was helping her father manage his money, but Larry was always short of cash and increasingly anxious. For a while, Larry thought he had withdrawn money and then misplaced it. When it was pointed out to him that his daughter was stealing from him, he was devastated.

The resident-services coordinator in the housing unit where Larry lived called Protective Services, the state program charged with investigating abuse of the elderly. Protective Services then referred Larry to the Boston Money Management Program.

"She takes the worry and pain out of my head."

At that point, things began to change for the better for Larry. Believing that Larry was not capable of making appropriate decisions about his Social Security benefit check, the Boston Money Management Program contacted the Social Security Administration. Boston Money Management's Deborah Grose informed Social Security that she had a volunteer, Jane Brayton, who was willing to serve as Larry's representative payee and manage his benefit check. Brayton then opened a checking account for him, to which she has sole access. Larry's Social Security check is now deposited directly into that account, and Brayton pays all his bills and makes sure he has enough money for incidentals.

Although Larry's daughter doesn't come around as much anymore, another daughter, after hearing of the situation, has become much more attentive, visiting Larry on a regular basis. And one by one, Brayton is getting Larry's overdue debts either paid or forgiven. Larry has a phone again and has enrolled in a daytime adult-health program that he enjoys immensely. Now that his money is being used wisely, Larry has funds he never had before to buy some creature comforts. Brayton says that the look on his face when he sits in his new La-Z-Boy recliner is indescribable.

Larry is happy with Brayton, too. "She's good. She takes a lot of pressure off of me," he says. "She makes me understand things and takes the worry and pain out of my head."

1 oz.

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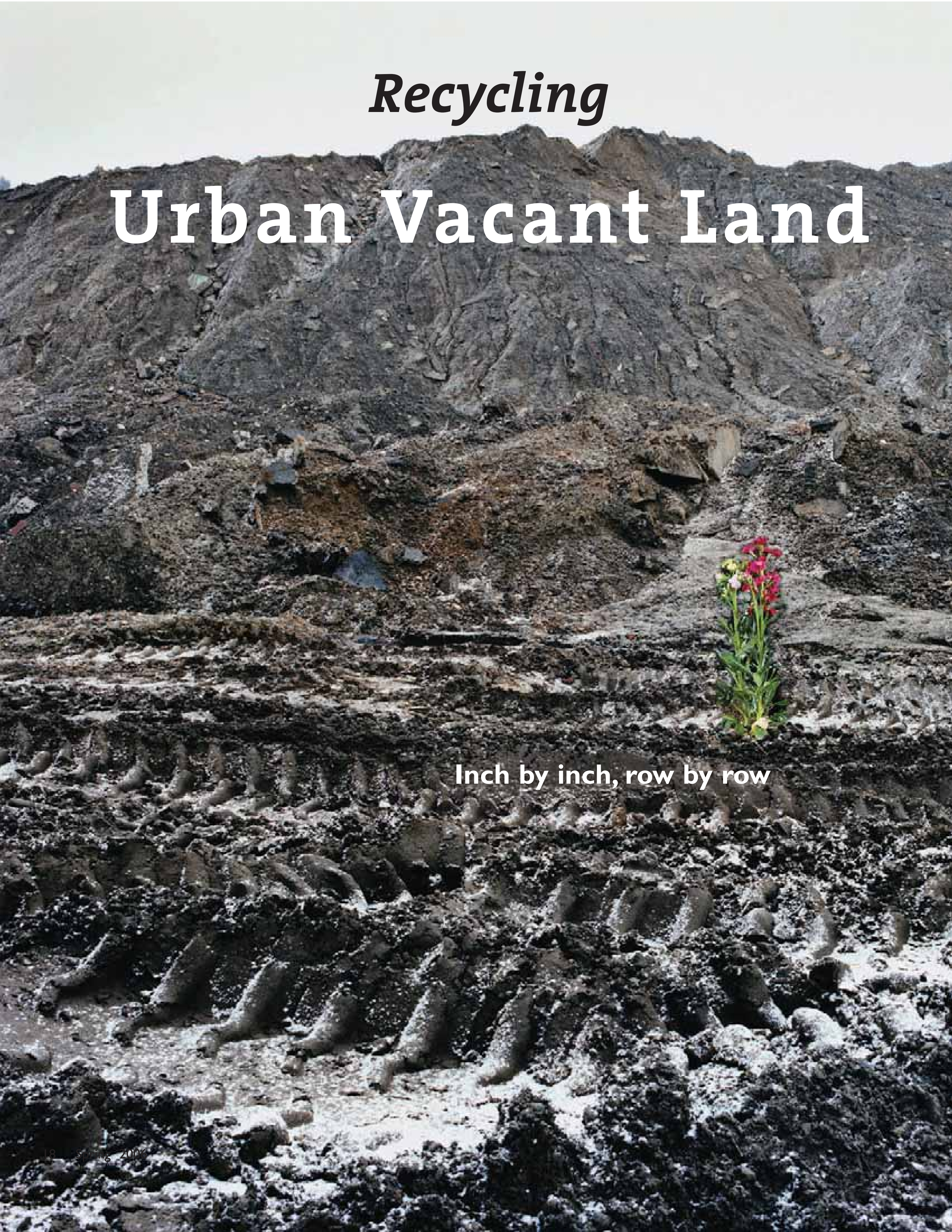
tematically review all financial records. Because representative payees have ready access to the elder's checkbook, they are monitored more frequently than bill-payer volunteers. For help with technical matters and policy issues, the program draws on the expertise of state and local advisory councils, consisting of Social Security managers, bankers, and other business professionals, plus a variety of advocacy groups.

Given the oncoming wave of retiring baby boomers, and given that people who are age 85 and older represent the fastest growing segment of the country's elderly population, the need for money-management services will undoubtedly increase. Volunteer-based programs such as the Massachusetts Money Management Program are a cost-effective way to promote the financial security of the elderly.

Richard A. Hylan *is statewide coordinator of the Massachusetts Money Management Program. He is based at North Shore Elder Services in Danvers, Massachusetts.*

Photograph on page 16 courtesy of the Age Center of Worcester Area

Recycling Urban Vacant Land



Inch by inch, row by row

Neighbors Reclaim Neighborhoods

Vacant, abandoned, and contaminated properties in urban areas can be both an eyesore and an opportunity. In an urban residential neighborhood, vacant land decreases property values and scares off development for both the actual site and the surrounding neighborhood.

But vacant land can also provide opportunities for neighborhood transformation. Sometimes scattered parcels, formerly the site of a corner store or dilapidated apartment building, can be magnets for civically engaged dreamers who, with enormous effort, transform these plots into urban gardens, new housing, or businesses. Such redevelopment may transform only a single lot, and the transformation may be short-lived. However, under the best circumstances, it may bring jobs, tax dollars, improved infrastructure, and even more development to the neighborhood – while reducing health and environmental risks.

Over the decades, changes in U.S. industrial structure have rippled through the economy. In New England, as industries have declined and relocated and then given birth to new industries, their fortunes have been reflected in cities, towns, and neighborhoods. The presence of these vacant, abandoned, and contaminated properties is one of the consequences of such changes. Some of these parcels may have been abandoned because of industrial decline, others because of population shifts from central cities to suburbs.

Revitalizing the Northeast

New England has some outstanding examples of reuse. Textile mills in Maynard, Massachusetts, became the headquarters of Digital Equipment Corporation (DEC) and today serve several other organizations. The former Boston Insulated Wire and Cable company in the Dorchester section of Boston became headquarters for the marketing firm Spire.

Yet some cities, towns, and neighborhoods continue to be overlooked by investment. When both the private for-profit and public sectors have passed over opportunities, nonprofit developers—community-based organizations including CDCs and other neighborhood planning and development organizations—have stepped in. They have done so in an effort to mitigate the negative effects of the abandoned sites as well as to incorporate the redevelopment into larger plans for reclaiming their neighborhoods.

Consider the Boston Insulated Wire and Cable Company site. In 1994 Dorchester Bay Economic Development Corporation (DBEDC) bought the contaminated 4.7-acre parcel, which had been abandoned for a decade. DBEDC redeveloped it by assembling multiple public, private, and community stakeholders, eliminating back taxes and multiple title problems and putting together a financing package with participation from at least 17 public, private, and nonprofit organizations. Having Spire headquarters there has meant more than 100 jobs, including some at entry-level. Spire also offers job training for residents in this lower income area.[1]

Another example of creative reuse of abandoned sites in inner city neighborhoods is Philadelphia's New Kensington Community Development Corporation (NKCDC). Since the mid-1990s, NKCDC has been converting abandoned sites into urban parks, urban gardens, and urban farms. On some sites, plantings, trees, and park benches have replaced piles of construction debris. These parks may serve only as transitional land uses; in the meantime they dissuade illegal dumpers from using the neighborhood as a solid waste dump. The conversion has been so successful that over time that NKCDC's challenge has shifted from dealing with abandonment to dealing with rising land values.[2]

Urban farms are an example of an even more ambitious nontraditional use than small parks. Just three miles from downtown Philadelphia, Greensgrow Farm sits on the site of a former steel-galvanizing facility. The U.S. Environmental Protection Agency (EPA) completed demolition of the site in 1988. Greensgrow began site development in 1998. Since then they have added a greenhouse, a seasonal nursery, and a farm stand.

Today, instead of steel products, the site produces agricultural products —lettuce, tomatoes, herbs, and flowers —grown in greenhouses and purchased directly by local restaurants. In addition, Greensgrow Farm, like other such enterprises, provides training and employment opportunities for neighborhood residents, including young people. It makes food available for homeless shelters and food kitchens, and it beautifies the neighborhood by planting flowers along the perimeter. The flowers are later sold to restaurants for table decorations.

by Rosalind Greenstein and Yesim Sungu-Eryilmaz

Lincoln Institute of Land Policy

The community building potential of recycling urban land is also apparent at Centro Agrícola in Holyoke, Massachusetts. Neighbors whose roots are in rural Puerto Rico pass on their agricultural skills to young people. The urban agricultural center has spawned a bakery, a restaurant, greenhouses that grow produce such as peppers and herbs, and a kitchen available to community entrepreneurs with catering businesses.

In the case of urban agriculture, the community benefit seems to precede the economic benefit. Neighbors —often acting through a community-based nonprofit planning and development organization—begin to dedicate themselves to neighborhood improvement. A spirit of community may be built around an urban garden, as Roberto Velázquez of Holyoke's Nuestras Raices explains: "Gardens are of great benefit to the community because they keep people busy and they bring people together to beautify the neighborhood."[3]

Beyond Sweat Equity

The investment of such community organizations may be strictly "sweat equity," but in the most successful cases sweat equity is supplemented with contributions from the private sector and from city, local, and national foundations. Both community labor and capital are needed. The volunteer labor is what cements neighbors' commitment to community revitalization. However, funds are also needed—to purchase tools, plants, soil, design services, and so on.

A 2004 study examining the direct impact of so-called greening investment on Philadelphia's neighborhoods found that improvements on vacant land resulted in increases of as much as 30 percent in surrounding housing values.[4] New tree plantings were shown to increase housing values by approximately 10 percent. In the New Kensington area of Philadelphia this translated into a $4 million gain in property values through tree plantings and a $12 million gain through lot improvements. Neighborhood improvements, increased values, and the spirit of community all appear to contribute to the mix that attracts newcomers.

Community-based organizations (CBOs) interested in redeveloping brownfield sites must be extremely skilled. Ideally, a CBO should embody a combination of sophisticated real estate developer, skilled community organizer, resourceful nonprofit agency director, and visionary strategic planner.

Moreover, as Margaret Dewar and Sabina Deitrick explain in their book *Recycling the City*, CBOs should consider how to ensure that their brownfield redevelopment is successful in a way that makes sense for their core mission of providing benefits to their community.[5] In other words, they need to pursue development in the context of their "existing community plans or goals—whether in housing, business development, environmental improvement, or targeted historic preservation."

Dewar's and Deitrick's evidence is based on case studies of CBOs in Pittsburgh and Detroit. In a Pittsburgh project, after the city proposed using a former steel site for riverboat gambling, which was opposed by the neighborhood residents and businesses, the community development corporation engaged in a master planning process with the Urban Redevelopment Authority of Pittsburgh.

The master plan guided the creation of a mixed-use development. The project helped achieve the goal of revitalizing a key area of the neighborhood and creating new jobs, some of which went to local residents. The neighborhood's success in planning for reuse of the former steel site stemmed from a neighborhood planning process begun in 1990 and its ability to connect the redevelopment project with the neighborhood and its goals.

But in Detroit, when an old industrial area was redeveloped, the community-based organization requested only part of what the residents wanted. Although it sought to prevent illegal dumping and to get trucks rerouted away from residential areas, it failed to request help with two of the low-income residents' most important needs: preference in hiring and relocation aid for neighbors closest to the project. The CDC was never able to reconnect the brownfield redevelopment with the neighborhood.

So although, CBOs may facilitate redevelopment on brownfield sites by using community organizing skills and by building partnerships, the success of such projects needs to be evaluated against the goals of the neighborhood and of the overarching desire for community betterment.

Rosalind Greenstein *is a senior fellow co-chair of the department of planning and development at the Lincoln Institute of Land Policy in Cambridge, Massachusetts, where* **Yesim Sungu-Eryilmaz** *is a research associate.*

Endnotes

[1] See Dorchester Bay Economic Development Corporation,. www.dbedc.com, and U.S. Environmental Protection Agency, www.epa.gov.ne/brownfields.

[2] Sandy Salzman, "Recycling Vacant, Abandoned, and Contaminated Properties in New Kensington,"http://www.communitylots.org/brownfields/courses.html.

[3] See http://www.nuestras-raices.org/new_page_4.htm.

[4] Susan Wachter, "The Determinants of Neighborhood Transformations in Philadelphia: Identification and Analysis: The New Kensington Pilot Study" (working paper, The Wharton School, University of Pennsylvania, Philadelphia, 2004).

[5] Margaret Dewar and Sabina Deitrick, "The Role of Community Development Corporations in Brownfield Redevelopment" in *Recycling the City: The Use and Reuse of Urban Land*, eds. Rosalind Greenstein and Yesim Sungu-Eryilmaz (Cambridge, Massachusetts: Lincoln Institute of Land Policy, 2004).

Denise Nappier
State Treasurer of Connecticut

Photograph courtesy of the office of the State Treasurer of Connecticut

As an identical triplet and the first woman and African American elected State Treasurer of Connecticut, Denise Nappier is hardly typical. But in some ways her background fits the model of those who pursue a career in public service. It includes, for example, parents who emphasized contributing to the betterment of society. Nappier's father was an architect and a Tuskegee Airman, her mother a paraprofessional in the education field. A native of Hartford, Nappier went to Virginia State University for her bachelor's degree and received a master's from the University of Cincinnati. In 1989, she was elected to the first of five terms as Hartford City Treasurer. She was elected State Treasurer of Connecticut in 1998. Since then, her office has safeguarded and increased the state's financial resources while simultaneously working to be a force for good. *Communities & Banking* recently had the opportunity to speak with Treasurer Nappier.

C&B: How did your past experience prepare you for being State Treasurer of Connecticut?

DN: My years as the treasurer of Hartford were helpful. When I first assumed that role, the city was in the midst of difficult economic times. I was eager to begin work on my platform to consider the corporate-citizenship record of the banks that managed city funds. However, many local banks were on the verge of insolvency, and my primary obligation was to protect the funds under my trust. The experience was a valuable lesson on being a fiduciary. As conditions improved, I was able to fully consider a bank's community

Breaking New Ground

reinvestment performance and put money in banks that were not only financially strong but also had demonstrated a commitment to reinvest in Hartford. It's what we refer to in the industry as the "double bottom line."

C&B: Explain how you focus on that double bottom line now that you serve the whole state.

DN: As a fiduciary I have a responsibility to hire vendors that can manage our banking service needs and to invest in portfolio companies that can protect and grow Connecticut's pension funds. But we also consider companies' role as corporate citizens—nontraditional financial or economic factors.For example, do portfolio companies have a commitment to workforce and board diversity? Do they treat their workers fairly? Do our vendors provide Connecticut jobs? This in no way conflicts with my fiduciary obligation. We've done our due diligence, and the pension fund has grown to $21 billion. At the end of fiscal year 2004, it had grown nearly $2 billion from the previous year, and in 2005, it grew another billion. Our investment performance is highly ranked within the industry.

C&B: So you use your investment clout to promote responsible corporate citizenship?

DN: Yes. When our portfolio companies are good corporate actors, it can go a long way toward improving the value of our shares. Connecticut is unique in that state law allows us to consider the social, environmental, and economic impact of our investments. This is not just a moral obligation: It's an economic necessity. Studies have shown that the way a company treats its workers and the larger community can have a direct effect on the bottom line.

C&B: I understand that when companies you invested in have broken laws, your office has not hesitated to sue.

DN: We go after the money. But litigation is a last resort after we have pursued all other avenues. We were the lead plaintiff in a class action suit against Waste Management, for example, and recovered $457 million for investors, the third-largest securities class-action settlement in U.S. history.

C&B: What role should a state treasurer play in helping individuals move out of poverty and become self-sufficient?

DN: From the beginning, I have been about increasing opportunities for Connecticut residents and acting as a catalyst to encourage financial education. Improving financial literacy allows people to become economically self-sufficient. This is particularly important for our young people. I have visited schools and helped to implement initiatives that teach students the ABC's of finance. My office helped establish the first Youth Financial Conference. In addition, we have promoted individual development accounts, which help low-income people save for a goal such as purchasing a home or starting a small business. IDAs provide matching money from public and private groups to help the poor build and maintain assets. More than 1,000 people have been or currently are participants in the state IDA program.

C&B: What actions did your office take on individual development accounts?

DN: I appointed a statewide task force in 2000 (the first of its kind) to see how we could expand IDA availability in Connecticut. My office brought in outside experts to explore the economic benefit to the state. We assembled banks, community development corporations, and state agencies to assess the feasibility of expanding IDAs. There were several groups in Connecticut with IDA programs, but the state needed to endorse the initiative to be eligible for a federal matching grant. Once the report was complete, legislation passed rather quickly—people really embraced the program once they saw the benefits for families and communities.

C&B: Where else does the matching money come from?

DN: I have counted on banks to participate as part of their community investment responsibilities. In fact, IDAs were first funded through the community reinvestment commitment my office helped secure during the merger of Fleet and Bank Boston. IDAs have a financial-education component, which makes them a natural for banks. Individuals who start saving in a bank through an IDA usually form long-term financial relationships with those institutions.

C&B: Describe some challenges you have faced.

DN: When I was first elected, there was a perception that I didn't know much about managing money, or that I was going to focus my attention on social issues — perhaps because I am a woman and black. But I see my responsibility as making the money grow, and I had nearly a decade of experience as treasurer of Hartford. Does my office does place high value on promoting programs that help Connecticut citizens build assets and improve their financial situation? Yes. But that is an economic necessity, not a "social issue."

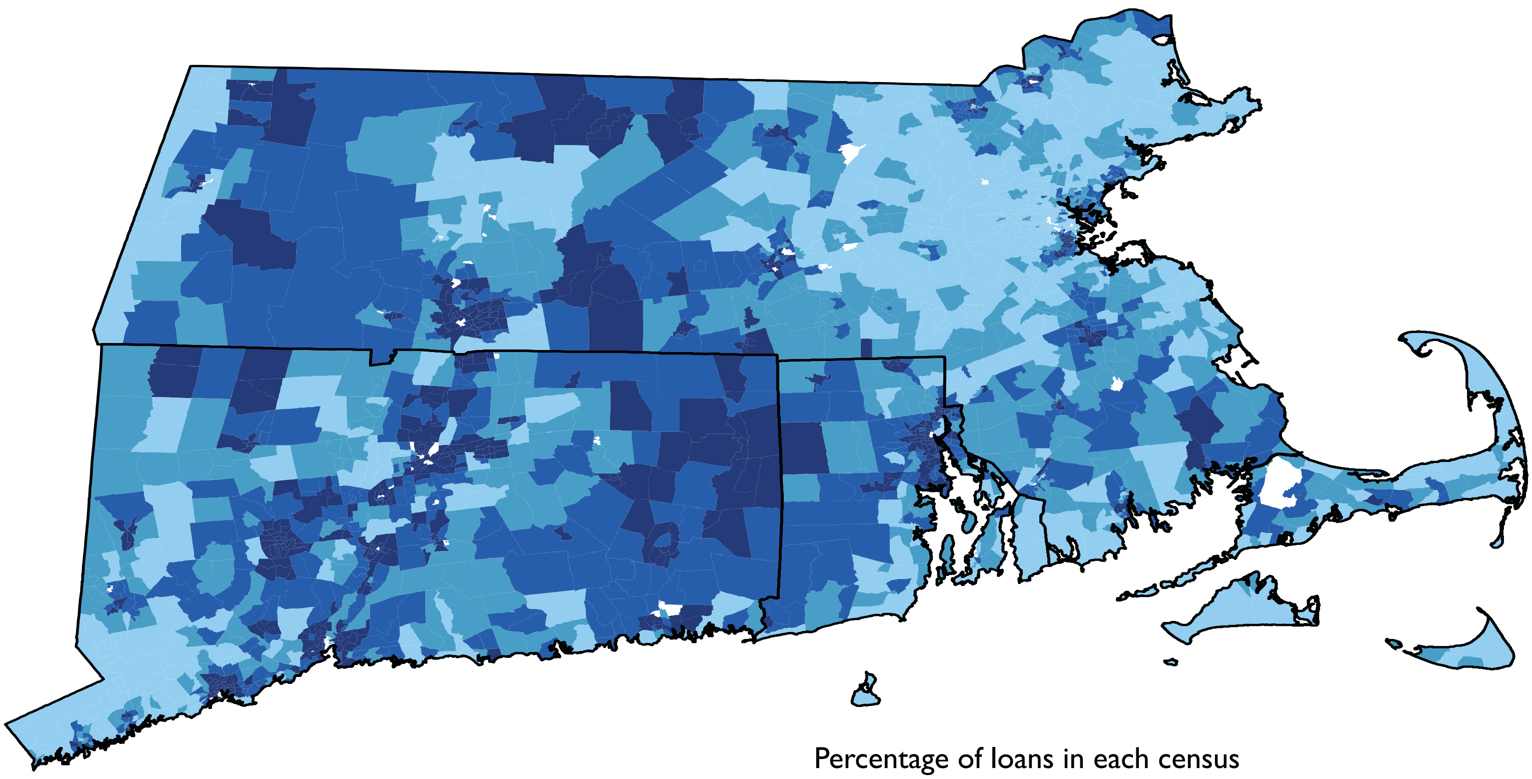
C&B: Explain your program for letting local investment companies manage part of the Connecticut Retirement Plans & Trust Funds.

DN: We set up an investment program called the Connecticut Horizon Fund. We invest pension funds in a central money manager. The central money manager farms out part of the money management to women-owned, minority-owned, emerging and Connecticut-based firms, and oversees their investment work. That eliminates previous barriers such as requiring a state pension-fund money manager to have at least $2 billion under management. And it lets us support smaller firms and the next generation of fund managers. We hope to invest between 2.5 percent and 5 percent of our retirement assets with these smaller money managers over the next few years and give them a chance to build a track record. With the playing field leveled, we expect them not only to generate solid performance, but to outperform some of the big money managers. We are all about growing the money.

Mapping New England

Higher-Priced Refinance Loans in Southern New England

In New England, 12 percent of refinance loans were higher-priced. Higher-priced refinance loans were much less common in eastern Massachusetts than in other parts of southern New England.



Percentage of loans in each census tract that are higher-priced

First Quartile	Less than 6 percent
Second Quartile	6 percent to 10 percent
Third Quartile	10 percent to 16 percent
Fourth Quartile	Greater than 16 percent
	Fewer than 10 refinance loans made in 2004

Source: 2004 HMDA Data
Note: Higher-priced loans are those with interest rates that exceed the yield on a comparable maturity Treasury security by three percentage points for first liens or five percentage points for subordinate liens.
Map: Ricardo Borgos, Federal Reserve Bank of Boston

HMDA

Home Mortgage Disclosure Act

New Pricing Data

In fall 2005, the Board of Governors of the Federal Reserve System published its first study of the new Home Mortgage Disclosure Act (HMDA) interest-rate data. The study included extensive national analyses of mortgage pricing patterns across racial and ethnic groups. The findings confirmed a commonly held belief about mortgage prices: Traditionally underserved minority groups were more likely than other populations to pay higher prices for mortgages. In general, the findings hold for New England.

The Subprime Market

Since the 1990s, the strong, rapid growth of subprime lending has dramatically changed the mortgage lending industry. Using risk-based pricing, lenders look at the characteristics of a potential borrower, estimate the chance of early termination of the loan (either through default or prepayment), and determine how to price the loan. To offset higher risks, lenders charge higher interest rates, fees, or both. With the flexibility of subprime lending, the industry can offer a wide variety of mortgage products to a wide range of households.

Julia Reade • Federal Reserve Bank of Boston

Many people believe the growth of the subprime market played a role in increasing access to credit for traditionally underserved populations. However, there is concern that these populations are more likely than others to be overcharged for credit. Subprime borrowers may be charged unreasonably high interest rates or fees. Also, applicants who qualify for prime, less expensive mortgage products may be steered to subprime products or subprime specialty lenders. It is generally believed that those patterns disproportionately affect minorities.

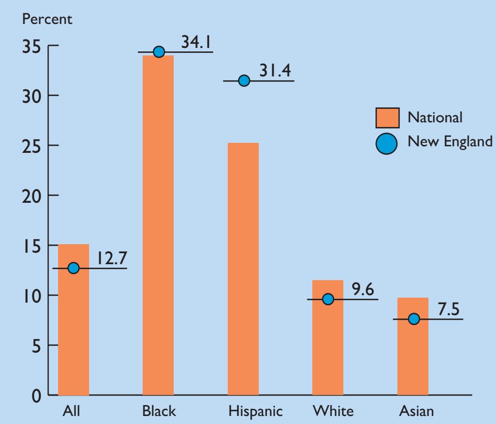
In evaluating overall access to credit, researchers and regulators have focused on denial rates. Historically, blacks have had much higher mortgage-denial rates than whites, and rates for Hispanics were somewhere in between. But as the subprime mortgage market grew, it became clear that this information was not enough. There was no information to show the price of loans, and there was concern that if there were discriminatory pricing practices, they were not being brought to light. By 1993, the Department of Housing and Urban Development (HUD) began compiling a list of lenders who specialized in subprime lending. Although the list showed that minority groups were more and more likely to receive loans from subprime specialty lenders, it did not necessarily show whether these groups were more likely to receive subprime loans. Furthermore, there were no data showing whether or not pricing differences existed across racial and ethnic groups.

In 2002, HMDA was amended so that data on pricing would start being collected in 2004. However, collection of the pricing data is not straightforward. The interest rate charged for each loan is compared with the yield on a comparable treasury security. If the spread exceeds a certain threshold, the lender must record the size of the spread in the HMDA data. The threshold depends on the type of lien on the loan. For loans with primary or first liens, the threshold is three points. For loans with junior or subordinate liens, the threshold is five points. These loans are often referred to as "higher-priced" or "high-cost."

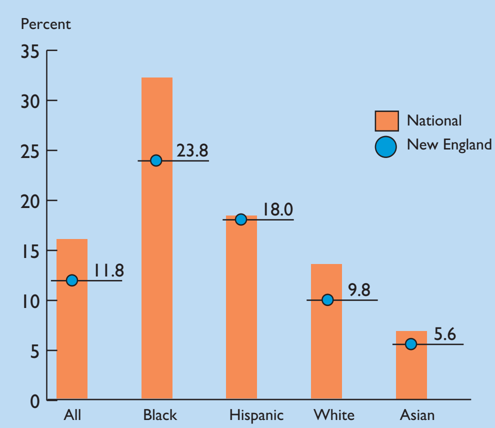
What We Have Learned So Far

The first analyses of the completed data set were published in September 2005 by Federal Reserve Board researchers. "New Information Reported under HMDA and Its Application in Fair Lending Enforcement" examined higher-priced loan originations (loan approvals) and the patterns across income, race and ethnicity, and gender.[1] The differences in patterns across racial and ethnic groups were significant—it was clear that most minority groups were much more likely to get higher-priced loans than whites.

Share of Home-Purchase Loans That Were Higher-Priced



Share of Refianance Loans That Were Higher-Priced



Source: Author's tabulations of 2004 Home Mortgage Disclosure Act Data. Note: Excludes transition period records.

A much higher share of mortgages were higher-priced for blacks and Hispanics than for non-Hispanic whites or Asians. (See the exhibit "Share of Home-Purchase Loans That Were Higher-Priced.") The patterns held for home purchases, refinancing, and home improvement. Generally, non-Hispanic whites and Asians had the lowest likelihood of higher-priced loans, whereas African Americans had the highest. Rates for Hispanic whites were somewhere in between.

The findings matched most expectations. However, one pricing pattern did not. For the actual cost of the higher-priced loans, there was almost no difference across racial or ethnic groups. For some loan products, whites paid slightly more than minorities.

One significant finding of the Board of Governors report was that much racial and ethnic disparity in higher-priced lending stemmed from the choice of lending institution. Blacks and, to a lesser extent, Hispanics were much more likely than whites to apply to institutions that typically originated higher-priced mortgages to applicants of all races and ethnicities.

There are many possible causes for the wide variations in lender-choice patterns. The Board of Governors paper describes a few. Applicants may believe they need a subprime loan (because of a low credit score, for example, or a small down payment) and select a lender with that specialty. It is also possible that subprime lenders have stronger outreach in minority communities than other lenders—or that minorities are steered by friends, brokers, or institutions to subprime lenders, whether or not they qualify for prime credit.

How Did New England Compare?

Overall, higher-priced lending was less common in New England than in other parts of the country. However, for patterns across races and ethnicity, results differed sharply depending on whether the loan was for home purchase or refinance.

For home purchase loans, Hispanics were much more likely to received a higher-priced loan in New England than in any other region. The proportion of loans to blacks that were higher-priced in New England was similar to the national average. In fact, higher-priced loans were almost equally common for New England's Hispanics and blacks, which differed from the rest of the nation. For whites, higher-priced loans were less common than they were in all but one other region. Combined, this made for some of the greatest disparities in the country. The pattern was consistent across most of New England's metropolitan statistical areas.

The patterns for refinance loans in New England were a marked contrast. (See the exhibit "Share of Refinance Loans That Were Higher-Priced.") All of New England's groups were among the least likely in the country to receive higher-priced refinance loans.

Much of New England's differences across racial and ethnic groups stemmed from applicants' choice of lenders.

As in the rest of the country, much of New England's differences across racial and ethnic groups stemmed from applicants' choice of lenders. The most popular lenders among many minority groups (as measured by the number of applications received from each minority group) were often lenders that were very likely to make higher-priced loans—to applicants from any racial or ethnic group.

For example, in New England, 31 percent of home purchase loans to Hispanics were higher-priced loans. This share was 47 percent at the five lenders who received the largest numbers of applications from Hispanics. (Each received more than 1,200 applications from Hispanics, and, combined, the five lenders received 30 percent of all Hispanic home-purchase applications). At these same five lenders, whites also had an unusually high likelihood of getting a higher-priced origination. Twenty-nine percent of loans to whites were higher-priced loans (compared with only 10 percent on average).

In contrast, at the five most popular lenders for whites, only 19 percent of loans to Hispanics were higher-priced. Whites at these lenders were still less likely than Hispanics to receive higher-priced loans—only 9 percent of loans—but the gap was only 10 percentage points and was significantly smaller than the 19 percentage-point gap at the five top institutions among Hispanics.

Julia Reade *is a senior research associate with the Federal Reserve Bank of Boston.*

Endnote

[1]Robert B. Avery, Glenn B. Canner, and Robert E. Cook, "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," *Federal Reserve Bulletin* (summer 2005): 344-394, www.federalreserve .gov/pubs/bulletin/2005/3-05hmda.pdf.

New England Public Policy Center

at the Federal Reserve Bank of Boston

The New England Public Policy Center (NEPPC) recently published a policy brief about Massachusetts' two newest housing policies, known as Chapters 40R and 40S. The new laws are smoothing the way for communities to meet the affordable-housing goals that they first encountered in Chapter 40B in 1969. The policy brief is available at the Center's web site: **http://www.bos.frb.org/economic/neppc/.**

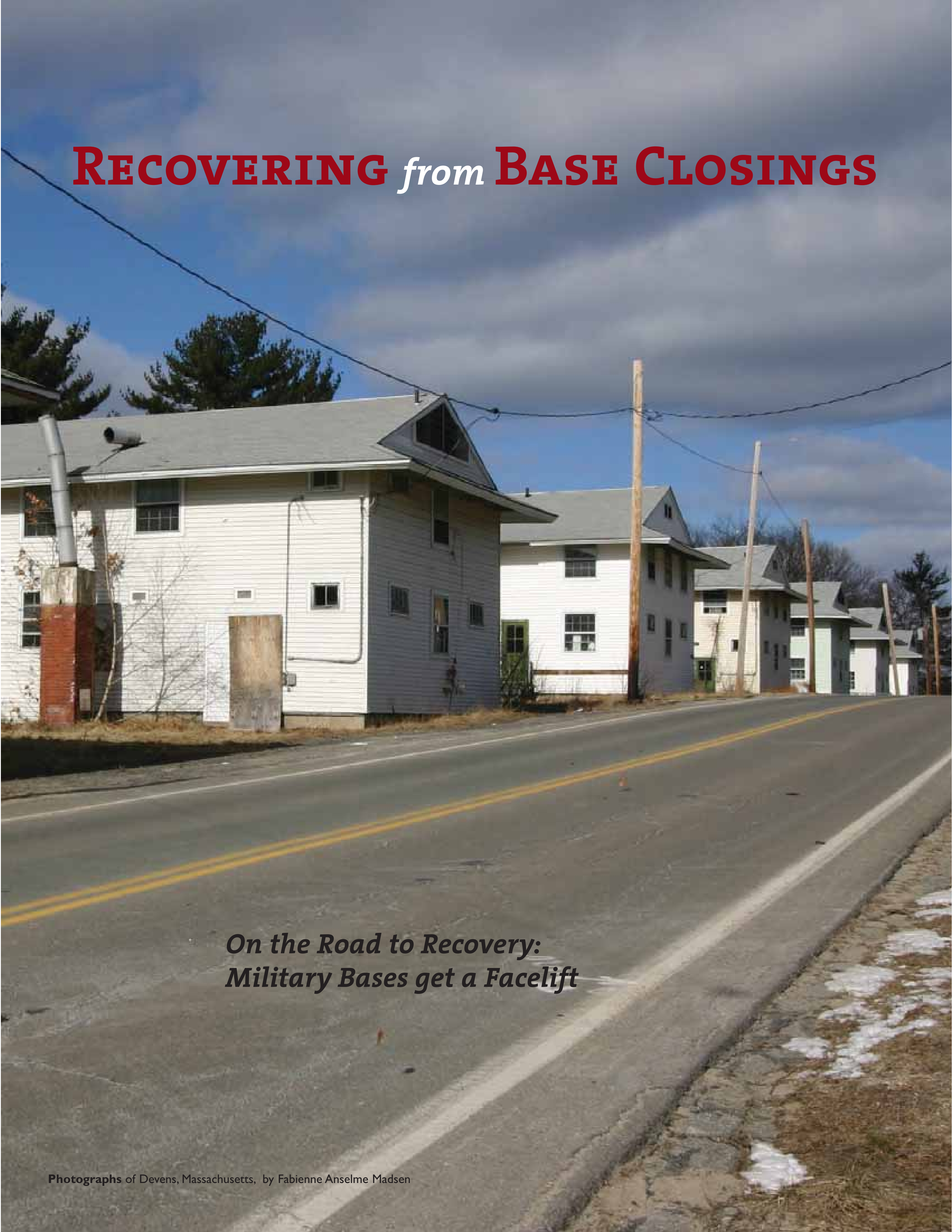
Massachusetts has long been recognized for employing state policy to promote affordable housing at the local level. Chapter 40B, which has achieved considerable success in compelling more communities to host affordable units, has nevertheless been unable to address local concerns about the impact of affordable developments.

Moreover, the difficulty of finding affordable housing grew steadily over the past decade in many places. The Commonwealth realized it was time to try a different tack and to align local interests with state interests. The new policies provide communities with financial incentives to produce more affordable and market-rate housing stock in established smart-growth zones. The hope is that communities will build enough such housing units to moderate housing price inflation.

As insurance for local fears of possible additional costs for schoolchildren in new affordable units, Chapter 40S offers funding assistance under certain conditions. Meanwhile, Chapter 40R rewards communities that plan town centers hosting denser development combined with affordable units. The policy brief analyzes the provisions of 40R and 40S and its predecessor, 40B, and explains how they are designed to address the concerns of both the Commonwealth and municipalities.

The New England Public Policy Center, a new venture at the Federal Reserve Bank of Boston, is dedicated to enhancing access to high-quality analysis on economic and public policy issues that affect the region, In addition to the brief on affordable housing in Massachusetts the Center has published working papers, research reports, and policy briefs on a variety of subjects of importance to the region. To learn more, please visit the Center's web site: **http://www.bos.frb.org/economic/neppc/.**

RECOVERING *from* BASE CLOSINGS



On the Road to Recovery: Military Bases get a Facelift

Photographs of Devens, Massachusetts, by Fabienne Anselme Madsen

by Antoniya Owens • Federal Reserve Bank of Boston

When Loring Air Force Base in Limestone, Maine, closed in 1994, the future looked bleak. More than 1,300 civilian jobs were lost, and 2,875 military positions were transferred. In all, more than 8,000 people—one-tenth of the population of Aroostook County—left. But today, despite Limestone's remote location near the Canadian border, Loring has been transformed into the largest business, industrial, and aviation park in the state of Maine. By 2005 more than 20 new businesses had relocated there, and nearly 1,500 new jobs had been created.

Fort Devens in Massachusetts and Pease Air Force Base in New Hampshire have similar stories of successful post-military redevelopment. Meanwhile, Stratford, Connecticut, is still recovering from the 1997 closure of the Stratford Army Engine Plant. Environmental cleanup of the heavily polluted site has stalled, hindering the successful transfer of property and the implementation of redevelopment plans. No new positions have been created to replace the 1,400 jobs lost. Some challenges facing communities affected by base closures are unique to each situation. Overall, however, successful redevelopment strategies share three critical features: partnerships; creativity and flexibility; and persistence.

Working Together

The redevelopment of a closed base often involves strong disagreements—especially if the base spans several communities. Thus, an important first step is for the communities to form a local redevelopment authority (LRA) with strong and determined leaders and representatives of all affected stakeholders—local residents and workers, government officials, civic leaders, and businesses leaders. Such an authority becomes the only body officially recognized to negotiate with the military and to receive property transfer and other federal assistance.

Partnering with Local Stakeholders

The ultimate success of redevelopment depends on partnerships with the communities—having a reuse plan that correctly identifies local needs and reflects local visions. The redevelopment authority should maintain a constant dialogue with the involved communities, local officials, and advocacy groups, and should include their input in transparent, realistic proposals. The redevelopment team at Loring, for example, kept stakeholders informed through multiple public hearings, a process that resulted in a solid redevelopment plan.

But consider the situation at Stratford. There are still no clear and consistent plans to act upon once the military completes the property transfer. Recently, there have been some disagreements between the Town Council—the plant's official redevelopment authority—and the site developers on whether the site should be redeveloped for residential properties (which would require more extensive and costly cleanup) or for previously agreed-on industrial and commercial purposes.

Partnering with Government

Partnerships with state government also are important. When a base covers several jurisdictions with different land-use regulations and building permitting, communities can ease administrative difficulties by coordinating among themselves and working with states to streamline procedures.

For example, the redevelopment of Fort Devens, which spans four towns,

was aided by state legislation creating a single permitting and approval agency, the Devens Enterprise Commission. The approval process now guarantees answers to applications within 75 days and has already helped attract 78 new companies offering more than 4,000 new jobs.

A word of warning: The closing of a base often creates hostility in the community toward the military and the federal government, which may hurt the community's ability to get assistance. A strong alliance with the federal government, however, can ease recovery by securing technical and financial assistance. The Loring Development Authority, for example, received nearly $9 million in grants from the Economic Development Administration and the Defense Department's Office of Economic Adjustment to repurpose the base's infrastructure, facilities, and functions.

The most significant blocks to base redevelopment are stalled environmental cleanup and delayed property transfer. In Connecticut, the cleanup process of the Stratford Army Engine Plant site is approaching 10 years. The plant's manufacture of commercial and military engines left the soil and buildings polluted with solvents and heavy metals. Without a comprehensive cleanup process, the site cannot even be used for industrial purposes. Progress has been hindered by a lack of coordination. The extent and cost of the cleanup are still unclear. This has delayed property transfer to the town, as state and local authorities are not willing to accept liability for the cleanup in case the Army does not provide enough funding.

In contrast, Loring's development authority early on established a partnership with the U.S. Environmental Protection Agency, Maine's Department of Environmental Protection, and the Air Force. Although Loring was heavily contaminated like Stratford, the collaborative spirit there helped in determining cleanup priorities, duration, and the effect on redevelopment. The cleanup, which exceeded $150 million, proceeded alongside base redevelopment and was never a major obstacle. Cooperation among all stakeholders avoided gridlock.

Creativity and Customization

No single formula for success fits every base-redevelopment project. Location, remoteness, climate conditions, available infrastructure, and the health and diversification of the local economy are bound to vary. A recovery's success depends on the ability of the redevelopers to customize strategies, taking into account the starting conditions, the needs of the local community, and the base's comparative advantages.

Rural and remote bases are generally considered difficult to redevelop because they have less-diversified economies and less-developed infrastructure. A base closing affects their economies more severely, and it is harder to attract new industries. The harsh winters at Loring certainly did not look like an asset.

According to Brian Hamel, former chair of the Loring Development Authority, initial prospects for redevelopment were uncertain, and a creative approach was needed. Using funding from the Office of Economic Adjustment, the LDA hired outside consultants to assist them with a Target Industry Market Study and an Aviation Task Force Study. The studies identified industries suitable to the region's conditions, infrastructure, and workforce. Industries deemed worth pursuing included light manufacturing, agriculture, food processing, and transportation distribution—all of which could benefit from the area's large open spaces, more than 300 buildings, and well-developed infrastructure.

The Loring Commerce Centre, which now encompasses the former military installation and is managed by the Loring Development Authority, leveraged the former airbase to create an aviation complex with runways, aviation operating systems, aircraft maintenance facilities, air cargo operations, and private aircraft operations.

In addition, because good telecommunications infrastructure and an abundant, educated, and relatively cheap labor force were available, the redevelopment authority decided to target information-based businesses. Sitel Corporation, which provides outsourced telephone-based customer service, expanded its call center in Loring to employ nearly 300 people and is considering increasing that number to 500.

Loring even managed to turn its harsh winters into an asset. The Maine Winter Sports Center, a newly formed nonprofit corporation, has established facilities and programs to stimulate the development of biathlons and cross-country and Alpine skiing. Its facilities in Presque Isle recently hosted the 2006 Biathlon Junior World Championships, attracting more than 250 young athletes from 29 countries and more than

20,000 spectators. Such events not only enhance the region's reputation, but also mean more business for local hotels, restaurants, and shops.

Be Proactive and Persistent

Attracting businesses to a new site is always difficult, but when the site is a former military base in a remote location, the task is truly daunting. In targeting potential employers, an aggressive and proactive approach in conjunction with a solid marketing strategy and a coherent, consistent message can make all the difference. "It's likely that businesses won't readily come to you—you need to go to them," says Hamel. "Develop strategies for approaching them. Travel to them, engage them, have them come and visit your community. The results from such an approach can be very different from simply phoning or e-mailing them."

The ultimate success of redevelopment depends on partnerships with the communities.

Developers in charge of attracting industry need to effectively advertise the region's advantages and incentive packages. Loring still aggressively advertises the strengths of its workforce, the available infrastructure, the low cost of doing business in Maine, and the fact that Loring is located in zones offering special tax advantages: the Maine Pine Tree Zone and the federally designated Rural Empowerment Zone. Similarly, in Massachusetts, Fort Devens promotes its wide array of state-sponsored economic incentives, including its simplified permitting process, low-cost financing options, competitive utility rates, competitive labor costs, and tax incentives.

Redeveloping a former military base into a vibrant community with a new face is a time-consuming, costly, bureaucratic, and arduous process. The transition can cost millions of dollars and can take years, even decades, to complete. Nevertheless, most communities around former military bases have succeeded in revitalizing and diversifying their economies. According to the Government Accountability Office, almost 85 percent of civilian jobs lost as a result of base closure or realignment have been recovered through redevelopment.[1] The rates of unemployment and average annual real per capita income growth generally fare better at redeveloped bases compared with average U.S. rates. Many former bases are even doing better than they were during the military presence. That should send a powerful message of hope. The exit of the military doesn't need to be the end; sometimes it is only the beginning.

Antoniya Owens *is a senior research assistant at the Federal Reserve Bank of Boston.*

[1] *Military Base Closures: Observations on Prior and Current BRAC Rounds*, United States Government Accountability Office Statement before the Defense Base Closure and Realignment Commission, May 3, 2005.

How Former Military Bases in New England Are Recovering

(as of October 31, 2004)

	Base-closure round	Closure date	Lost civilian positions	Transferred military positions	New jobs	Proposed major land uses
Loring Air Force Base (Limestone, Maine)	1991	September 1994	1,311	2,875	1,161	agriculture, aviation, conservation, commercial, education, industrial, office, recreation, residential
Fort Devens (Ayer, Harvard, Shirley, and Lancaster, Mass.)	1991	March 1996	2,178	1,662	4,180	commercial, conservation, correctional, government, health care, industrial, museum, office, recreation, residential
Pease Air Force Base (Portsmouth and Newington, N.H.)	1988	March 1991	400	2,250	5,124	aviation, education, government, health care, industrial, office, recreation, retail commercial, transportation
Stratford Army Engine Plant (Stratford, Conn.)	1995	December 1997	1,400	5	0	industrial

Source: *Economic Transition of BRAC Sites: Major Base Closures and Realignments 1988-2004*, Department of Defense Office of Economic Adjustment.

Inside this issue:

The Afterlife of Military Bases

Photographs of Devens, Massachusetts, by Fabienne Anselme Madsen

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